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The Social Security and Medicare Trustees Report Again—And Again Problems Have Worsened

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The annual Social Security and Medicare Trustees reports released on April 23 discussed changes in the programs that have occurred over the previous year and changes in their overall financial condition as measured in a number of ways. Once again, both reports share a disturbing commonality: The financial condition of both programs is terrible and got significantly worse with another year of legislative inactivity.

The key particulars in this case are that Social Security is facing a financial abyss that got $200 billion deeper over the past year, while Medicare's abyss deepened by $3.8 trillion.[1]

Unfortunately, we don't have comparable statistics for Medicaid, but Medicaid's future is just as troubled. In their current forms, these programs are simply and unquestionably unsustainable.

To put these figures in some perspective, the federal government's cash flow deficit for 2008 is forecast to be below $250 billion, or about 1/16th of the worsening in the finances of Social Security and Medicare combined. Put another way, the $4 trillion increase in the unfunded obligations in these programs is about a third the size of our total economy.

The Trustees are not alone in sounding the warning. David Walker, Comptroller of the United States and head of the Government Accountability Office, has appropriately made this issue a top priority. Congressional Budget Office directors talk about it frequently. The Administration has featured the problem for years in the annual budget release and elsewhere. And members of the think tank community from right to left have formed the Fiscal Wake-Up Tour to educate Americans across the country about the problem and discuss solutions.

Why Does This Matter? Tax receipts flowing into Social Security in 2007 are projected to exceed expenditures by $88 billion, and Medicare draws on general revenues for much of its funding. With the overall budget deficit now below 2 percent of gross domestic product (GDP), it's fair to ask why Congress and the American people should take much notice of the 2007 Trustees reports. There are many good reasons to do so:

1. Modest congressional action now can dramatically reduce the funding shortfall in years to come. By their nature, these programs are structured to operate over, and are analyzed over, long time horizons. A good analogy is that small amounts saved early add up to big returns in retirement.
2. Congressional action now is important to future seniors who will rely in part on these programs for their financial security. Seniors generally have little ability to alter their financial circumstances once they have retired from the workforce. For this reason, changes in Social Security and Medi-

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care need to be made well in advance, and to be fully transparent, so workers have adequate time to adjust their current behavior and retirement planning accordingly.

3. Congressional action now on Social Security and Medicare will have very real consequences for the ability of future Congresses and Administrations to meet other spending priorities such as national defense, education, and the environment. These consequences are already apparent: The Office of Management and Budget projects that Medicare and Medicaid spending, absent any reforms, will rise by $222 billion, or over a third, over the next five years. If taxes remain approximately at current levels as a share of GDP, and if the appetite for deficit spending remains limited, the health programs will increasingly cramp discretionary spending. The arrival of the baby-boom generation into retirement and the rapid growth in health care costs will only exacerbate these tensions. Congressional appropriators may already be awakening to the reality that their freedom to spend on pet projects has been curtailed not by stingy budget rules, but by the health care programs.

4. If Congress fails to act today, the children and grandchildren of tomorrow will face only two relevant options. One option is to slash retirement benefits for seniors. For example, in 2041, the year when the Social Security Trust Fund is projected to be exhausted, benefits will need to be cut by just over a quarter for outlays to come back into balance with tax receipts.

   The alternative is to impose a vastly greater tax burden than would be tolerated today to pay future benefits. One can debate whether taxes "should be part of the solution," and part of that debate should be an honest recognition that higher taxes would mean slower future wage and job growth. It is unclear why future workers should pay higher taxes, have fewer job opportunities, and receive lower pre-tax wages because today's workers and retirees promised themselves higher benefits than they were willing to pay for, but that will sort itself out in time. In any event, given the magnitude of the problem, it is as unreasonable to suggest that Congress can tax its way out of this problem as it is to deny the problem in the first place.

What Is the State of Play? The Administration, from the President on down, has tried repeatedly to rally sufficient political forces to achieve reforms, with one noteworthy success. Congress passed and the President signed the Deficit Reduction Act in 2005, shaving almost $51 billion over 10 years off the growth in Medicare and Medicaid spending. The changes were modest, but they were also the first of their kind since 1997.

Following the 2004 elections, the President gave scores of speeches from coast to coast about how Social Security could be made sound for future generations. He argued for personal accounts, but he also showed that a handful of minor, phased-in changes to the program could return it to solvency. Regrettably, Congress did not take up the challenge. Some in Congress argued there was no problem, or at least no urgency. Others countered that the real problem was Medicare, not Social Security, and that the Administration should therefore focus its efforts on Medicare.

In response, the President's budget released in February of 2007 offered meaningful proposals to slow the growth in Medicare spending. The President's proposals would shave $252 billion off the growth in Medicare spending over the next 10 years according to the Trustees. Over the next 75 years, a common point of reference for these programs, the President's proposals would fill a quarter of the Medicare abyss.

These proposals are especially apt because the Medicare Trustees report, for the second year running, indicates that the general revenue share of Medicare spending will exceed 45 percent during a seven-fiscal-year period. The various parts of Medicare are funded by a combination of payroll tax receipts, beneficiary premiums, and a draw from general revenues. The 2004 Medicare reform bill included a so-called trigger. Under this "trigger," as

1. These figures refer to the change from 2006 to 2007 in the unfunded obligations in Social Security and Medicare, respectively, on an infinite-horizon basis.

the 45 percent threshold has now been exceeded this year and last, the law directs the President to submit a proposal for action to Congress. There is nothing particularly magical about the 45 percent figure. It was deemed an appropriate early warning threshold. We have now crossed that threshold, the warning has been sounded, and Congress should act to strengthen Medicare's finances.

What Should Be Done? The textbook answer to what should be done is that the responsible committee chairpersons and leadership should begin crafting a bill to restore Social Security and Medicare to solvency immediately. That is why academic textbooks often have limited value in public policy: The chosen actors are right, but the goal is misidentified. Recognizing the highly charged political environment, the season of the President's term, the unfamiliarity of many Members with the policy alternatives, and simply the magnitude of the problem, this Congress and the Administration should act, but they should also focus their attention on the realm of the possible. This means taking a few easy steps with Social Security and/or Medicare to bring them under control gradually by focusing benefits more on the basis of income.

Social Security. Though the recent debate on Social Security reform was largely associated with the push for personal accounts, there are many good ideas for improving program solvency that could be achieved relatively easily and painlessly. Probably the foremost of these is progressive indexing. Progressive indexing simply means that the Social Security benefits of low- and middle-income retirees would be indexed to nominal wage growth, as under current law, while the benefits of upper-income retirees would be indexed to inflation. Since nominal wage growth is typically significantly faster than inflation, the net effect is an increasingly progressive benefit formula. At the same time, total growth in benefit outlays is slower because the benefits of upper-income retirees grow less rapidly than under current law as a result of being indexed to inflation rather than the faster nominal wage growth rate.

Medicare. Now that the Medicare trigger has been tripped, Congress should also act to reduce the Medicare shortfall, starting with the proposals the Administration advanced in this year's budget, to which Congress can and should add its own ideas. Some of these proposals include the usual shifts in provider payments that are needed to avoid having Medicare overpay for services. Medicare, after all, operates as an insurance company, and payment rates for services need to adjust from time to time according to market circumstances.

In addition, the Administration proposed to means-test, or "income relate," the Medicare Part B subsidy to parallel the premium subsidy structure in Part D. Under current law, Medicare Part B beneficiaries pay a premium for their coverage equal to 25 percent of the program's cost, with taxpayers picking up the tab for the other 75 percent. Under the Administration proposal, all Medicare beneficiaries would continue to have their Part B premiums subsidized, but the subsidy rate would decline to 65 percent for families with incomes between $160,000 and $200,000 and would fall in increments to 20 percent for families with incomes above $400,000.

This proposal increases the progressivity of Part B subsidies while reducing total Medicare costs. It should be a win-win for legislators of all political stripes. The provider payment reforms and the reforms in the Part B subsidy together represent major steps toward rectifying Medicare's terrible fiscal condition.

Conclusion. The latest Social Security and Medicare Trustees reports confirm again that these two large and vital programs for seniors are unsustainable in their current form. While one can always quibble with the underlying assumptions, the basic conclusions stand, and the Trustees have met their responsibility to report the facts. Many solid, incremental reforms have been identified for both programs that Congress could debate and enact. It is time now for the true trustees of these programs, the Congress and the President, to act on these reforms.

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